MEDPAC Medicare Payment Advisory Commission

MEETING BRIEF

March 10-11, 2005

A mandated study of payment rates, payment areas, and risk adjustment for MA local plans

ISSUE: Medicare Advantage (MA) local plans are facing substantial changes. In 2004, the MA program began using a new system for setting local capitation rates, including AAPCC rates, which are based on local FFS spending. In addition, the MA program began using a new system for risk adjusting payments. In 2006, Medicare Advantage will have a new system of setting payments that will use plan bids as well as local capitation rates. The MMA directs MedPAC to complete a report that addresses three questions related to these changes. What factors underlie the geographic variation in AAPCC payment rates? What is the appropriate payment area for local plans? How well does the CMS-HCC, the risk adjustment system that CMS began using in 2004, predict beneficiaries' costs? This brief contains our analysis of these questions and re-visits a previous MedPAC analysis of a policy that increases risk adjusted payments so that MA local plans are held harmless in the aggregate against the impact of the CMS-HCC.

KEY POINTS: AAPCC rates vary widely among counties. This variation is a concern because previous use of AAPCC rates resulted in perceptions of inequity. Beneficiaries in counties with high rates typically had more plans to choose from and were offered more generous benefits. We identified how much of the variation in AAPCC rates is due to county-level differences in the cost of inputs and special payments to hospitals in the form of IME, GME, and DSH. The remainder is attributable to providers' practice patterns, beneficiaries' preferences for care, and mix of providers.

Our analysis of the appropriate payment area for local plans focuses on the fact that counties—the current payment area—often have large annual changes in AAPCC rates and that adjacent counties often have very different capitation rates. Both these issues could be addressed with a larger payment area. We considered three alternatives to counties, all using counties as the building block.

We evaluated the predictive accuracy of the CMS-HCC using predictive ratios. For a group of beneficiaries, a predictive ratio is the mean of their costliness predicted by a risk adjustment system divided by the mean of their actual costs. The closer a predictive ratio is to 1.0, the better the risk adjuster has performed. Our results indicate that the CMS-HCC performs much better than a risk adjustment system that uses beneficiaries' demographic information.

Finally, we conclude that the policy of offsetting the effect of risk adjustment on aggregate payments to MA local plans should not be continued. The Commission has recommended that program payments should be equal between the MA and fee-for-service programs. Any policy that increases MA payments to offset the effect of risk adjustment is inconsistent with that recommendation.

ACTION: At this meeting, staff seek the Commissioners' feedback on draft recommendations.

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